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SUBJECT: SERBIAN TELECOMS REGULATOR OFF TO A ROCKY START

SUMMARY

1. Two years after the passage of the Serbian Law on Telecommunications, the Republic Telecommunications Agency was established and finally became operational on December 19, 2005. Shortly after its inception, however, the Government of Serbia (GOS) suspended the Agency's license-monitoring function during the GOS revocation of cellular-provider Mobtel's license, justifying this action on grounds of national interest. The Agency should soon resume these functions and become legally and financially independent, although other ministries still do not support the role of the Agency. END SUMMARY.

REGULATORY AGENCY BECOMES OPERATIONAL AFTER TWO YEARS

2. The Republic Telecommunications Agency was formed only recently pursuant to the Serbian Law on Telecommunications adopted in April 2003. After two years of delays, the Serbian Parliament finally elected the President and the members of the Agency's Management Board in May, 2005, and the Agency finally became operational on December 19, 2005. Its mission is to raise the efficiency of existing providers, introduce new and improve old services to modernize the telecom infrastructure, and create conditions for the sector's further development.

3. The regulatory function of the Agency includes establishing the rules for participants in a liberalized market and issuing the licenses that permit access to the telecommunications market. The Agency also sets prices for monopoly services, sets policy for network interconnections and line leasing, monitors overall network service quality, and monitors compliance with license requirements.

CONTROLLING AND MONITORING FUNCTIONS HAVE BEEN REVOKED

4. On March 29, econoff met with Jovan Radunovic, President of the Agency's Management Board, to discuss the Agency's role in the privatization of newly formed company Mobi 63, the former Mobtel. The Serbian government has approved an agreement with a consortium of Austrian businessmen, led by Martin Schlaff, on establishing a joint telecommunications company called Mobi 63 as successor to Mobtel. This new company gives Serbia 70 percent and Austrian investors 30 percent of the company. According to Finance Minister Dinkic, the initial price for the company and license will be EUR 800 million, with EUR 320 million for the license alone.

5. Radunovic explained that 10 days after the Agency became operational, its monitoring and controlling functions were revoked for 120 days by the Government of Serbia (GoS) to facilitate revocation of the Mobtel's license on December 29, 2005. The GOS justified its action as necessary to protect state interests. The Ministry of Capital Investments cited provisions in the Law of State Administration to withdraw some functions of the budget-based Agency. However, Radunovic believes the Ministry should not have intervened since the Law on Telecommunications established the Agency as independent, and the Agency was established by the Parliament, not by the government. (Other sources tell us Radunovic voted against the Mobtel action within the agency, although we are not aware of the specifics.)

6. After talks with Dinkic and Minister of Capital Investments Velimir Ilc, Radunovic believes that this problem will soon be overcome. Moreover, the GoS on April 4 adopted a detailed procedure for privatization of Mobi 63 that designates the Agency as responsible for issuing the license for the new operator of Mobi 63. The Privatization Agency will handle the sale of the assets of Mobi 63 - network, customer base, etc. Radunovic does not expect other problems concerning the privatization of Mobtel.

MINISTRY JEALOUS OF AGENCY'S ROLE

7. Radunovic expressed frustration over the Agency's relationship with the Ministry of Capital Investments, which previously had the authority to monitor and control telecoms. Radunovic said that the Ministry is trying to amend the law to completely remove the Agency from the picture.

8. According to the law, the Government should adopt a Strategy for Telecommunication Development proposed by the Ministry. The Agency as an independent regulator would then

be responsible for implementing that strategy. Last year, the Ministry formed a working group of employees from Mobtel and Telecom Serbia to write the strategy, but the strategy was never adopted, according to Radunovic, because the draft favored Mobtel and Telecom and was not seen as in the best interest of the Serbian telecommunications sector. Radunovic said that the agency has responded by forming its own council of experts that will prepare such a strategy for presentation to the Ministry. The council also will provide advice on amendments to the telecom law that are necessary to harmonize it with EU directives.

19. After a long process, the GOS recently chose Goldman Sachs to develop a strategy for privatization of the entire sector, but this contract appears to have been superceded by the Mobtel developments. (The GOS, in late December, revoked Mobtel's license and seized its assets in a dispute with Milosevic-crony Bogoljub Karic. Karic owned a majority in Mobtel, with the state holding the rest, but the two sides were locked in a dispute over ownership of Mobtel. Many believe that the increasing role of Karic's political party also figured in the GOS action.) The development of the cellular sector would have been a key focus of the strategy, but a Goldman adviser told econ chief that the strategy is effectively moot because of the GOS plan to sell Mobi 63 and then refrain from issuing a new license for a prescribed period (except under certain restrictive conditions). A separate investment bank was chosen by the GOS to handle the sale of Mobi 63, leaving Goldman on the sidelines.

UNBUNDLING OF TELEKOM SERBIA

10. Concerning the future of Telekom Serbia and its monopoly position, Radunovic believes that the unbundling of Telekom will not end its monopoly position automatically. Although Telekom's fixed line monopoly expired in June, 2005, as a practical matter, the rules necessary to permit other operators to access its network have not been adopted. Telekom Serbia, of which 20 percent is owned by Greek telephone company OTE, also controls the second cellular telephone provider. According to current law, Telekom Serbia should be divided into three separate parts - fixed line, mobile telephony and Internet.

11. However, Radunovic sees the unbundling of Telekom Serbia as out of step with the current global trend toward unification of services in one company. He supports keeping the services within one company but operating each as a separate business unit, with its own financial statements. He also favors introducing new services and new technology as a means to overcome the monopoly position of Telekom, in part to avoid problems in using the current Telekom infrastructure. However, liberalization of the market and usage of the current infrastructure owned by Telekom will be the topic of the telecom development strategy - whenever it is approved by the government.

CONFLICTS LOOM

12. The GOS, on March 29, approved a document that is to form the basis for the government's telecom strategy. This non-binding statement of intent proposes that Serbia Telekom be awarded spectrum at 3.5-3.6 gigahertz, spectrum that already is used by three small companies for broadband wireless internet. One U.S. company is considering a proposal to create a WiFi zone in the small city of Indjija, perhaps in cooperation with USAID, but such a proposal would require use of this frequency. The Jefferson Institute, which is working on this proposal, told ECON FSN that Serbia Telekom's proposal to use this spectrum to provide wireless fixed telephony to villages would prevent the growth of a WiFi/WiMax service industry in Serbia, a type of service that already is popular in Croatia. However, the control of this frequency is in the hands of the Regulatory Agency for Telecommunications.

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